

UNITED STATES

Agency for International Development

**The
Thailand
Financial Markets
Development
Program**

Final Report

Prepared by PPA Incorporated, December 1, 1991

Introduction.

Thailand has experienced remarkable economic development and social progress since the founding of the U.S. Agency for International Development (USAID) program in Thailand four decades ago. Real GDP growth, for example, has averaged nearly 10% for the last five years, with the manufacturing sector contributing an increasingly important share. Beginning in 1985, AID shifted its program target away from a traditional focus on poverty and rural development to one which focused on the problems of Thailand as an emerging middle income country and, more recently, on facilitating Thailand's greater integration into the world economy.

Thailand's growth path in the 1990s will require even broader and deeper integration with the world economy. Because continued Thai progress on this path is now of direct interest to the United States, both countries have clear interests in minimizing continued constraints to expanded Thai integration with the world economy.

USAID is now developing a new five year program in Thailand that will be designed to further assist in Thai economic development in the decade of the 1990s. Three areas are critical to Thailand's ability to maintain competitiveness over the decade:

1. Expansion of the quantity and improvement of the quality of Thai human capital.
2. Facilitation of the ability of the international and domestic financial markets to meet the rising demand for investment capital.
3. Amelioration of environmental degradation which now increases costs and diminishes growth prospects in key industrial and tourism sectors.

The USAID Mission in Bangkok is now committed to a new Thai-U.S. Partnership Fund that reflects the emergence of Thailand as an advanced developing country.

A major long-term objective of the public and private sector leaders of Thailand is for the country to become a regional financial market center in the global marketplace. In order for Thailand to become a regional financial center, the country needs to develop a two sided market, beginning with primary and secondary equity and debt markets. In a viable two-sided market, domestic savings are accumulated into professionally managed pools of capital, which are managed by institutional asset managers and are invested in securities with economically rewarding returns. Both sides of the market have to develop along with the market mechanisms themselves. Consequently, there are three key ingredients of a viable securities market that need to be improved in Thailand.

—Savings need to be mobilized into pools of assets which are professionally managed with investments in a diversified portfolio of securities

and financial instruments. With the exception of the government sponsored Industrial Finance Corporation of Thailand and its subsidiary Mutual Fund Company, there are no asset management organizations managing large pools of capital with diversified investment strategies.

—Viable securities markets need to be developed in order to provide trading liquidity to the asset managers. While there is a very active stock market in Thailand, it needs significant improvement. The trading floor of the Stock Exchange of Thailand (SET) is now automated. A second stage of automation of surveillance procedures and settlement, clearing, and custody of transactions and securities is necessary before Thailand can become a regional securities market. Additionally, the quality of financial information on the companies listed on the SET needs substantial improvement. Finally, there is no bond market and one needs to be established.

—A critical mass of securities and financial instruments that represents underlying values of economically and financially sound enterprises needs to be underwritten by a competitive investment banking and project finance industry. Although the Thai securities firms are very active in the competition for initial public offerings of the stock of companies which list on the SET, they have little experience in debt offerings.

These are all development problem that need to be solved. The Financial Markets Development Program is designed to solve these problems that stand in the way of Thailand becoming a regional financial center. Each program activity is designed to solve both general and specific problems. All of the FMDP activities cut across the problems of limited human and financial resources. The FMDP is a carefully crafted partnership program that will link American technical capability with Thai institutions and people on a shared funding basis that gives each of the parties both a financial and programatic stake in a successful accomplishment of the project objective.

The USAID Financial Markets Development Program is expected make an important contribution to expanded relationships between the Thai and the U.S. financial communities. The program will bring in the expertise of U.S. asset management firms to help the Thais establish a competitive money management industry, help the Thais to improve the quality and efficiency of their stock market, and help the Thais to develop a bond market with the interaction of U.S. investment bankers. Presently there is very limited interaction between the two financial communities, but this is expected to change dramatically with the ramp-up of the FMDP.

As a result of the February 1991 coup, this was a year in which the financial markets development program was monitored, assessed and critiqued in anticipation of a return to normalcy of the USAID program funding with elections and a launching of the Thai-U.S. Partnership Fund in 1992. In the post election period it is anticipated there will be 6-8 financial markets-capital projects

support activities positioned for funding with others ready to be placed in the pipeline. The program will be broken down into three areas: asset management, securities markets, and investment banking-project finance. A separate report is attached which describes the results of the experiment to form environmental project finance consortia and recommends the next steps to be taken when the USAID program resumes full operation with the Thai-U.S. Partnership Fund.

National Savings Mobilization and Asset Management.

Development Problem:

With the exception of the Industrial Finance Corporation of Thailand (IFCT) and its subsidiary, the Mutual Fund Company, there are no asset management organizations that employ the broadly diversified investment strategies that characterize a mature financial market like the United States. Although there are several firms—dominated by Thai securities and finance companies—which manage small provident funds, their investment strategies are primarily oriented towards equities listed on the SET. And at present, the provident funds do not represent a significant national asset base. The current government will soon issue new mutual fund licenses to break the monopoly of the Mutual Fund Company. This is a trend in the right direction and indicates that there is an opportunity to develop asset management organizations in Thailand that will make long term commitments in a full range of investments, including long term bonds.

Nevertheless, this lack of existing asset management firms underlines four significant problems that must be faced in order to achieve the objectives of this element of the FMDP. Competitive asset management structures must be organized and qualified Thai asset managers must be trained to staff these new firms.

Secondly, there are cultural barriers to the development of an American type of asset management industry in Thailand. Lending policy at most Thai banks is very short term oriented. Additionally, most equity investors are more inclined to be short term traders than serious long-term investors. As a consequence, some financial institutions that might legally be empowered to employ a diversified investment strategy will not be inclined to do so without substantial educational persuasion. This new idea of a different investment strategy—something that has never been done by these institutions—will face serious cultural barriers in Thailand, and this is a problem that must be overcome in order to achieve the objectives of the program.

Thirdly, there is a very limited amount of long term capital available for investment in Thailand, with the capital requirements to fund the large currently planned infrastructure projects far in excess of existing and available funds.

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Private savings need to be increased significantly and funnelled into asset management organizations that will investment them in financially viable long term projects.

Finally, there are legal problems that must be resolved before a long-term diversified investment strategy will be widely employed in Thailand. Insurance companies, for example, are by law restricted in the types of securities in which they are allowed to invest. A carefully executed market research project will undoubtedly uncover similar restrictions that govern the investment policies of other institutions.

Expected Contribution to the Goals of the Financial Markets Program:

The two asset management projects are designed to solve these problems which this program element faces. There will be a two phase program in the first project.

Phase one will be a market survey of pooled funds in Thailand and the potential for their management by a U.S firm and a Thai financial institution joint venture.

The IFCT Market Research Project is designed to be a short four months project that will be conducted by a professionally qualified American organization that will have a senior analyst spend a total of approximately four months located at the IFCT and work with the IFCT staff to explore the organizational, cultural, and legal barriers to the employment of more diversified investment strategies in Thailand. This project will quantify the existing and potential Thai pools of capital, determine why the assets in these pools are currently managed by limited strategies, and develop a plan for introducing a more diversified strategy in the management of each pool of capital.

Phase two of this project will seek to establish at least one U.S.-Thai asset management joint venture contractually involved in the management of all or part of one of these pools of capital in 1992.

If this project is successful, the contractor will have the opportunity to receive continued funding in future years to organize additional joint venture pools of capital, train personnel, reform the legal framework and thus make a significant dent in the organizational, cultural, and legal barriers to the employment of more diversified investment strategies in Thailand.

The second project will be a program of technical assistance for the committee planning Thailand's national social insurance program to help manage the funds that will accumulate under the national retirement program, which will seek to tackle problems of inadequate capital supply.

The information and experience gained from the market research and joint venture project will be used also in designing the proposal for technical assistance to the committee that is responsible for implementing the social security program

and designing the national retirement program. The goal contribution of this project will be to structure and fund a very professionally designed national retirement program that fits the needs of Thailand and also generates \$2-3 billion of cash flow annually that could be managed by U.S.-Thai joint venture asset management firms. This project would enable the IFCT Market Research Project to gain critical mass in removing the organizational, cultural, and legal barriers to the employment of more diversified investment strategies and ultimately result in 4-6 joint ventures positioned to or actually managing the retirement funds. The U.S. asset management partners in these joint ventures would initially provide the technical and professional capabilities to solve the human resource problem and provide sufficient Thai professionals to staff these growing firms.

If the two asset management projects are successfully implemented, they will have important social, economic, and financial impacts. The creation of a long-term national saving and retirement program is an important step in building a safety net for people who reach retirement age and can no longer rely on personal earnings for the basic necessities of life. With sound investment of these funds by professional managers, these savings can be protected and enhanced for the beneficiaries of the program. If prudently invested in well managed private infrastructure and commercial projects, this domestic source of funds will enable Thailand's economic growth to continue. Additionally, an annual retirement program cash flow of \$2-3 billion, partially invested in the Thai equity and debt markets, would provide depth and breadth to the stock market and funds for the initial bond offerings required to establish a primary bond market.

Objectives:

1. To quantify existing pools of capital that might be managed by joint ventures of U.S. asset management firms and Thai securities firms and establish at least one U.S.-Thai asset management joint venture contractually involved in the management of all or part of one of these pools of capital in 1992.

2. If objective one is achieved, the second objective will be to organize a series of joint ventures across the spectrum of asset pools in the future years of the program.

3. To develop a national retirement program that will generate \$2-3 billion annually and be managed by U.S.-Thai joint venture asset management firms.

The objective would be to have this research project lead directly to at least one U.S.-Thai asset management joint venture contractually involved in the management of all or part of one of these pools of capital in 1992. This would be a prototype success project.

The information gained from this market research project will be used in designing the proposal for technical assistance to the committee that is responsible

for implementing the social security program and designing the national retirement program. The objective of this project would be to have a very professionally designed national retirement program that fits the needs of Thailand and also generates \$2-3 billion of cash flow annually that could be managed by U.S.-Thai joint venture asset management firms. The objective would be to have 4-6 joint ventures positioned to or actually managing the retirement funds, depending on how long it takes to establish the retirement program.

Therefor, the year two objective is to have the IFCT market research project completed and lead to two actual joint ventures to manage \$100 million of Thai institutional assets either in place or in the process of being set up. Additionally, the first phase of the national retirement program policy planning should be completed and this project should be in the implementation phase, with the prospects assessed for the U.S.-Thai joint venture management of the assets which will result from this implementation phase.

The year five objective of the asset management element of the FMDP will be to have the funding of the retirement program underway and to have at least five U.S.-Thai asset management joint ventures, with each of them managing \$100-500 million.

Statement of Work, Including Deliverables:

The contractor will:

1. Conduct a short four months project that explores the organizational, cultural, and legal barriers to the employment of more diversified investment strategies in Thailand that will:

- Define and quantify the existing and potential Thai pools of capital.
- Determine why the assets in these pools are currently managed by limited strategies.
- On a case by case basis, develop a plan for introducing a more diversified strategy in the management of each pool of capital.

2. Organize an asset management joint venture with a Thai partner.

3. Assess the feasibility and desirability of USAID technical assistance to the committee implementing the social security program that will design the national retirement program. If this project warrants USAID funding, the contractor will also develop a scope of work for the project.

Management and Staffing:

These two asset management projects should be conducted by a major U.S.

firm that has international asset management experience and the ability to oversee the technical aspects of structuring the national retirement program. The project will require a manager and a technical consultant.

Duration, Timing and Reporting Requirements:

1. The contract will be for 12 months.
2. The contractor shall submit a work plan by the end of month one.
3. The contractor shall submit quarterly progress reports.
4. The contractor shall submit a final report that contains a recommendation for either continuation or termination of this project and a justification for the recommendation.

Budget:

Salaries	36,000
Travel	10,000
Support	10,000
Total	\$56,000

Statement of Competitive Procedure Proposed for Contractor Selection:

A search should be made for a qualified U.S. financial organization that has the interest in and a capability for managing both the IFCT Market Research Project and the assessment of whether or not USAID should assist the Social Security Office with the development of the National Retirement Program.

Securities Market Development

1. A Program of Technical Assistance Between the Stock Exchange of Thailand and the New York Stock Exchange:

Development Problem:

There are several general problems which impede the development of the Thai securities markets. The major generic problem is obvious. As a developing marketplace, Thailand does not yet have all of the human resource capabilities required to achieve the technical objectives of the FMDP. Consequently, in the very least, this could mean a delay in reaching the overall objective of developing Thailand into a regional financial marketplace.

Operational efficiency is also an important ingredient of a viable regional

financial market. It will be essential for the SET to follow up the automation of its trading floor with projects for computerized clearing, settlements, and custody of transactions and securities and an installation of a computer program for self-regulation of trading. Without implementation of such projects, the SET will be unable to handle the increased volume associated with a substantially increased level of professional investing by the new asset management firms. Furthermore, without this increased operational efficiency, it is unlikely that cross-listing of NYSE listed stocks would take place. The NYSE will have little interest in cross-listing in a primitive marketplace.

Expected Contribution to the Goals of the Financial Markets Program:

The SET is very interested in exploring the acquisition of the surveillance software from the NYSE, the NYSE's Integrated Computer Assisted Surveillance System (ICASS). It was tentatively agreed between the technical representative of the two exchanges that they would proceed to examine the feasibility of adapting ICASS to the market environment of the SET in a two step process. The first step will be to have a technical team from the NYSE spend time at the SET for a joint evaluation of the feasibility of adapting all or separate components of ICASS to the SET market environment. That first stage evaluation would take several months, with a decision to move forward to an implementation phase—either through purchase or lease—in 1992. If this evaluation proceeds to the implementation phase, it is possible that the U.S.—Thai Partnership Fund might provide human resource training for the SET staff that will be necessary for use of the adapted ICASS software and new computer hardware.

If this activity is successfully pursued, it would be the first stage of the technical exchange between the SET and the NYSE that would make significant contributions to the FMDP goal of improving the efficiency of the Thai Stock Market. This activity would be followed by additional programs to modernize the SET with computerized clearing, settlements, and custody of transactions and securities.

Objectives:

The goal of this project will be to continue the development of the Thai stock market, with the following intermediate term objectives:

1. A follow-up contract to the floor automation of the SET by an American company or consortium that is well on its way to completion of (a) computerized clearing, settlements, and custody of transactions and securities and (b) an installation of a computer program for self-regulation of trading.

2. Cross listing of 5-10 securities in both markets.

3. The planning underway for computerized options, futures and other

derivative products markets.

Statement of Work, Including Deliverables:

In cooperation with the management of the SET, the contractor will examine the SET's capabilities in the areas of surveillance, clearing, settlement, custody, computer networking, and new financial products. During the term of this contract, the technical exchange program should make concrete progress on the implementation of a computer surveillance system and have the scope a well developed plan for a system that automates clearing, settlement and custody of transactions; a computer network; and new financial products.

Management and Staffing:

A U.S. consultant with knowledge of NYSE operations should link the expertise of the NYSE to the SET and gradually develop a close working relationship between the two exchanges that will result in cross listing of securities. The project will require a manger, and administrative assistant, a secretary and a technical consultant.

Duration, Timing and Reporting Requirements:

1. The contract will be for 12 months.
2. The contractor shall submit a work plan by the end of month one.
3. The contractor shall submit a quarterly progress report.
4. The contractor shall submit a final report that contains a recommendation for either continuation or termination of this project and a justification for the recommendation.

Budget:

Salaries	24,000
Travel	24,000
Support	24,000
Total	\$72,000

Statement of Competitive Procedure Proposed for Contractor Selection:

A search needs to be done for a qualified contractor.

2. A Program to Establish Active Primary and Secondary Markets for Bonds:

Development Problem:

The specific problems facing the development of a bond market are the mirror image of those facing the asset management component of the program. With the exception of the IFCT, there is no human or organizational infrastructure for developing and placing debt instruments.

There are also cultural problems which stand in the way of the development of a vigorous investment banking industry and an active bond market. Investors do not understand debt instruments and the benefits of portfolio diversification to include debt securities. Moreover, the short term orientation of the Thai financial markets limits the ability of investors to understand that some portion of savings is truly long-term and can be invested with the higher yields that are typically earned on long-term debt.

Similarly, a lack of knowledge of these instruments on the part of managers of many corporations will be a barrier to the development of an active bond market. These corporate managers need to be educated about the advantage of reducing financing rollover risks by the use of long-term debt to finance long-term projects, as opposed to using short-term debt that must be refinanced. They need to understand the risk reduction benefit of financing long-term projects at a fixed interest rate. One positive step might be the use of commercial bank guarantees on a few large initial issues to remove any questions regarding credit risks associated with long-term maturities. This too is an education issue that must be faced before this cultural problem can be solved.

Additionally, there are legal and regulatory problems that must be overcome before a viable bond market can be developed in Thailand. Just as the Thai infrastructure is straining to support the current pace of business development and economic growth, the Thai legal framework does not adequately address the needs of many sophisticated investors and financial markets participants, although many of these problems may be remedied by the new Thai Securities Exchange Commission legislation which is expected to be approved by the current Cabinet.

The lack of a treaty to eliminate double taxation of U.S. businesses is a further impediment to increased U.S.-Thai commerce and a cumbersome process of repatriation of dollars limits freedom of movement in the market. There is also a need to review the tax treatment of equity and debt investments to determine if it is possible to treat debt instruments more equitably.

Finally, there is the problem of investor confidence related to quality of information. A combination of better quality audited statements, some sort of bond rating mechanism, and insurance against the credit risk related to this lack

of quality information will have to be developed before a large scale bond market will be feasible in Thailand.

Expected Contribution to the Goals of the Financial Markets Program:

If a viable bond market were developed in Thailand, it would facilitate financing of some of the massive investments, on the order of \$6-8 billion per annum, required for power, telecommunications, transport, and water and waste water systems and thus make a major contribution to the goals of the Financial Markets Program.

Within the IFCT organizational structure there is a Capital Markets Research Institute (CMRI). It is the intention of the IFCT to have the CMRI play an important role in developing and implementing policies, programs and projects for the improvement and expansion of the Thai capital markets. Among the projects which the CMRI would like assistance in undertaking are:

1. Development of a corporate bond market.
2. Developing a primary and secondary bond market.
3. Financing environmental projects.

This project would provide funding for an American corporate finance expert or firm to work with the CMRI on a targeted program to develop a bond market. If successful, this activity would make an important contribution to the FMDP goal of providing a viable and liquid capital market for Thai asset managers.

Objectives:

The objective of this project will be to establish a primary and secondary bond market in Thailand through large scale Bt debt offerings associated with the TOT-CP-AT&T two million lines, the EGAT power projects, the Thai International equipment needs, PTT energy projects, the Bangkok Sewer Project and other large infrastructure and private company capital projects. The 1992 objective will be to organize one state owned enterprise long term debt financing.

The intermediate term objective would be to have 5-10 issues totalling \$1 billion in which at least five Thai and two U.S. securities firms are making liquid secondary markets.

Statement of Work, Including Deliverables:

In cooperation with the management of the CMRI, the contractor will help to construct a plan for developing a bond market in Thailand jointly with the CMRI. During the term of this contract, substantial progress should be made on

one bond offering of a dollar value of 100 million or more.

Management and Staffing:

The project will require a full time manger and a secretary.

Duration, Timing and Reporting Requirements:

1. The contract will be for 12 months.
2. The contractor shall submit a work plan by the end of month one.
3. The contractor shall submit a quarterly progress report.
4. The contractor shall submit a final report that contains a recommendation for either continuation or termination of this project and a justification for the recommendation.

Budget:

Salaries	115,000
Travel	50,000
Support	35,000
Total	\$200,000

Statement of Competitive Procedure Proposed for Contractor Selection.

A search for a consultant/firm with superior corporate finance qualifications should be made.

Investment Banking

1. Environmental Infrastructure Project Consortia. See the separate report and recommendations on this subject which is attached.

2. A Program With a Thai Financial Institution to Manage an APRE Environmental Guarantee Fund.

Background:

At the time of the February coup, there was a draft of a term sheet that would have set up the Development Facility of Thailand—a \$3 million guarantee facility that would be managed by the IFCT. The IFCT is an important private sector institution in Thailand because it is currently the only entity in Thailand

with both the professional capability and legal authority to engage in the broad based asset management strategy characteristic of participants in advanced financial markets like the United States. This guarantee facility is currently available for fiscal 1992. This transaction could easily be completed when USAID funding resumes in Thailand, if the facility is still available at that time. This could be one of the first transactions in the Financial Markets Development Program.

This facility could also be focused on financing environmental projects, which is a primary interest of both the IFCT and USAID.

Development Problem and Expected Contribution to the Goals of the Financial Markets Program:

Both the development problem that this project would address and the contribution that it would be expected to make to the FMDP are covered under the Securities Market Development section of this report that addresses the establishment of active and primary and secondary markets for bonds. This project would be a contributor to the development of a bond market in Thailand.

Objective of the Activity:

The objective for the Development Facility of Thailand would be to facilitate two environmental project financings in 1992 and have this facility grow to annual A.I.D. commitment of \$20-30 million with partial guarantee of 7-10 debt related financings in progress in the intermediate term.

Statement of Work, Including Deliverables:

This project could easily be folded into the bond market development program, managed by the IFCT, and overseen by the contractor who works with the CMRI to construct a plan for developing a bond market in Thailand. The initial \$3 million guarantee facility should be employed with two financings completed or in progress during the period of the contract.

Management and Staffing:

This project should be staffed by the IFCT and the consultant to the CMRI.

Duration, Timing and Reporting Requirements:

1. The contract will be for 12 months.
2. The contractor shall submit a quarterly progress report.

3. The contractor shall submit a final report that contains a recommendation for either continuation or termination of this project and a justification for the recommendation.

Budget:

Support \$50,000

Statement of Competitive Procedure Proposed for Contractor Selection:

Contract with the IFCT, which has a unique capability to manage the guarantee facility.